

MARKET UPDATE**The market gets frothy**

The student loan industry has not yet become a concentration of huge players. And it won't.

By PAUL SHELDON

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Businesses are starting to resume or initiate constructive efforts on the thought that the commercial sky is no longer falling. Most economic statistics are showing improvement. And generally speaking, low interest rates are providing student loan companies with abnormally high returns. Thus, the student loan industry is in very good financial condition to enter an economic upswing and continue to innovate and grow.

Consolidation or expansion?

Is the number of industry participants consolidating or expanding? On the 2002 list of top 100 FFEL loanholders (See the July 2003 *Greentree Gazette*, page 90), the top two positions are safely held by Sallie Mae and Citibank. Those two firms hold almost half of the outstanding loans. However, there will be numerous changes among the top 10.

Five of the loanholders among 1997's top ten were gone from the top 10 list in 2002. Three were acquired by Sallie Mae: SMS, Student Loan Funding, and Nellie Mae. The other two, Chase and BankOne, are joint venture partners with Sallie Mae. Sallie Mae has been a strong force for consolidation in the industry. New products and services developed by Sallie Mae in the same five years shows clearly the benefits that result from economies of scale.

What about the five firms that have taken their places? One is a money center bank and four are student loan companies, three of them not-for-profit companies. In the student loan business, not-for-profits have often been secondary markets, viewed as producing limited primary market initiatives and possessing little ability to innovate.

The growth of these four not-for-profits dispels the myth. The Michigan

State University deal provides further evidence of the emergence of this sector. None of the "Michigan Students First" participants are top-ten holders. Yet each has proved to be a worthy competitor in that heady contest.

Room for one and all

It's well apparent that all kinds of companies can prosper in this industry. Among the competitors for the Michigan business were three firms in the top ten, a fast-growing smaller company, and the winner: Michigan Higher Education Student Loan Authority, the 30th largest holder. Smaller players with capital and energy can compete with the largest players. Meanwhile, the terms negotiated for the student loans insure that schools and students will be the beneficiaries.

On the top 10 list this fall we will see three or four new players who did not exist in 1997. They formed and grew on the consolidation wave, and they will be full service student loan contenders in the future.

Borrower benefits kick up the competition

There is competition at every level, and almost all players are finding a niche. The Michigan deal won't be the last time smaller players with competitive advantages successfully compete for business. At the same time, as large players gain market share, they will innovate and set higher service standards. Meanwhile, borrower benefits reflect a frothy market (as opposed to "irrationally exuberant"). Further improvement on this front seems unlikely.

It has been several years since an important player has left the industry. American Express comes to mind, and their exit was said to be related to corpo-

rate strategy, rather than the ability to succeed in the business. In fact, the American Express operations were morphed into another business which has seen remarkable growth and success.

A rash of large bank mergers in the 1990s had a concentration effect in the student loan industry. Among the more interesting: Banc One and First Chicago, Wells Fargo and Norwest, Bank of America and Nations Bank, Fleet Bank and Bank of Boston. All eight of these banks were important student loan players. Their mergers decreased the number of players, which launched the opinion, shared by me at the time, that the student loan business would become a concentration of huge players. This has not happened.

The number of important players is actually expanding. In addition, several large corporations outside the student loan business are more than interested in student loans as they observe the terrific financial results being posted by Sallie Mae.

What is the benefit to schools?

Why should this be of interest to business officers and financial aid administrators? Because competition is the reason that the rankings keep changing and new players enter the game. If the order of top 10 holders stayed the same, status quo would predominate and innovation would be limited. Conversely, today's student loan firms are working hard to apply capital, human resources, and technology to make a better mousetrap. ■



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